[JOINT COMMITTEE PRINT]

DESCRIPTION OF H.R. 3525 (PERMANENT TAX TREATMENT OF FRINGE BENEFITS ACT OF 1983)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON AUGUST 1, 1983

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

JULY 28, 1983

U.S. GOVERNMENT PRINTING OFFICE

23-162 WASHINGTON : 1983 JCS-36-83

J862-43
H782-26

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INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has scheduled a public hearing on August 1, 1983, on H.R. 3525 (Permanent Tax Treatment of Fringe Benefits Act of 1983). The bill was introduced on July 12, 1983, by Messrs. Stark and Conable.

The first part of the pamphlet is a summary. The second part is a general overview of the Federal tax treatment of statutory and nonstatutory fringe benefits. This is followed by a brief statement of some of the principal tax issues relating to fringe benefits. The final part of the pamphlet is a description of H.R. 3525.

I. SUMMARY

Statutory exclusions for certain fringe benefits

As a general rule, if an employer-provided fringe benefit program qualifies under certain statutory provisions of the Internal Revenue Code, the benefits provided under the program are excludable (generally, subject to dollar or other limitations) from the employee's gross income for income tax purposes and from wages for payroll tax purposes. The employer's costs of providing benefits which are excluded from the employee's income nonetheless generally are deductible by the employer (as are employee benefit costs not so excluded), provided that such costs constitute ordinary and necessary business expenses deductible under Code section 162.

The Internal Revenue Code provides specific exclusions, among others, with respect to employer provision of (1) health or accident benefits; (2) up to $50,000 of group-term life insurance; (3) up to $5,000 of death benefits; (4) meals and lodging for the convenience of the employer; (5) legal services; (6) commuting through use of a van pool; (7) employee educational assistance; (8) dependent care assistance; (9) certain benefits provided to members of the Armed Services; and (10) and parsonage allowances.

Tax treatment of nonstatutory fringe benefits

The Internal Revenue Code defines gross income as including "all income from whatever source derived" and specifies that it includes "compensation for services" (sec. 61). The U.S. Supreme Court has held that Code section 61 "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected."

In actual practice, however, the economic benefit test has not been rigidly followed. Thus, where compensation is paid in some form other than cash, issues as to taxability of certain fringe benefits have been resolved by judicial decisions, regulations, rulings, or other administrative practices which take into account several different factors.

The Economic Recovery Tax Act of 1981 (P.L. 97-34) extended through December 31, 1983 the moratorium, first enacted in 1978, on the issuance of Treasury regulations relating to the income tax treatment of nonstatutory fringe benefits.

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Under the bill, certain fringe benefits provided by an employer would be excluded from the recipient employee's gross income for Federal income tax purposes and from the wage and benefit base for purposes of social security and other employment taxes.

The excluded fringe benefits would be those that qualify under one of the following four categories as defined in the bill: (1) a no-additional-cost service, (2) a qualified employee discount, (3) a working condition fringe, or (4) a de minimis fringe. The bill would include rules with respect to parking provided to employees, demonstration use of an employer-provided car by auto salespersons, and employee use of gyms and other recreational facilities on the premises of an employer. Also, the bill would provide an exclusion for certain tuition reductions provided by and at a school or college to its employees, or their spouses or children. In the case of a no-additional-cost service, a qualified employee discount, parking, or a tuition reduction, the exclusion would apply only if the benefit is made available to employees on a nondiscriminatory basis.

Any fringe benefit which does not qualify for exclusion under the bill (for example, free or discounted goods or services which are limited to corporate officers) or under another specific statutory fringe benefit provision is taxable to the recipient, under Code sections 61 and 83, at the excess of its fair market value over any amount paid by the employee for the benefit.

The provisions of the bill generally would take effect on January 1, 1984, except that the tuition reduction exclusion would apply with respect to education furnished after June 30, 1984.

II. OVERVIEW OF TAX TREATMENT OF FRINGE BENEFITS

A. Statutory Exclusions

In general

As a general rule, if an employer-provided fringe benefit program qualifies under certain statutory provisions of the Internal Revenue Code, the benefits provided under the program are excludable (generally, subject to dollar or other limitations) from the employee's gross income for income tax purposes and from wages for payroll tax purposes. The employer's costs of providing benefits which are excluded from the employee's income nonetheless generally are deductible by the employer (as are employee benefit costs not so excluded), provided that such costs constitute ordinary and necessary business expenses deductible under Code section 162.

The Internal Revenue Code provides specific exclusions, among others, with respect to employer provision of (1) health or accident benefits; (2) up to $50,000 of group-term life insurance; (3) up to $5,000 of death benefits; (4) meals and lodging for the convenience of the employer; (5) legal services; (6) commuting through use of a van pool; (7) employee educational assistance; (8) dependent care assistance; (9) certain benefits provided to members of the Armed Services; and (10) parsonage allowances.

Nondiscrimination rules

Many of the present-law exclusions for statutory fringe benefits include rules prohibiting discrimination in favor of owners, officers, shareholders, or highly compensated employees.

Under these rules, a benefit plan or program generally must meet a requirement of nondiscrimination as to eligibility to participate, by covering a classification of employees determined by the Internal Revenue Service not to result in prohibited discrimination. A self-insured medical reimbursement plan or a group-term life insurance plan may also satisfy the requirement by covering a stated percentage of employees.

The eligibility rules generally permit employees covered by a collective bargaining agreement to be excluded from consideration if the benefits provided by the plan or program were the subject of good faith bargaining between the employer and employee representatives. The eligibility rules for self-insured medical reimbursement plans and group-term life insurance plans also provide that employees need not be taken into account if they have not completed three years of service or are part-time or seasonal employees (or, in the case of self-insured medical reimbursement plans, if they have not attained age 25).

The present-law nondiscrimination rules applicable to certain types of fringe benefit plans and programs also prohibit discrimina-

tion as to contributions or benefits. With respect to self-insured medical reimbursement plans, or group-term life insurance plans, present law specifically requires that all benefits available to officers, 10-percent shareholders, or highly compensated individuals must also be available to all other plan participants.

Under present law, if a plan is determined to discriminate in favor of employees who are officers, shareholders, or highly compensated, the otherwise applicable income exclusion generally is denied for all benefits provided under the plan, including those benefits provided for rank-and-file employees. (The nondiscrimination rules generally do not provide express guidance as to when an employee is considered highly compensated, or the extent of stock ownership required before an employee is considered a shareholder.) However, under a discriminatory self-insured medical reimbursement plan or group term life insurance plan, only those employees with respect to whom discrimination is prohibited are required to include amounts in gross income; other employees retain the benefit of the income exclusion.

Cafeteria plans

Under present law, an employer may maintain a cafeteria plan under which an employee may choose from a package of employer-provided fringe benefits, some of which may be taxable (e.g., cash or group-term life insurance in excess of $50,000) and some of which are nontaxable (e.g., health and accident insurance). The mere availability of cash or taxable benefits under a cafeteria plan will not cause an employee to forfeit an otherwise applicable income exclusion (sec. 125). Thus, benefits provided under a cafeteria plan generally are excluded to the extent that nontaxable benefits are elected.

No exclusion is permitted, however, for participants who are highly compensated individuals if the cafeteria plan discriminates in favor of such individuals as to eligibility or as to benefits or contributions. For this purpose, a highly compensated individual includes an officer, a five percent shareholder, a highly compensated individual, or a spouse or dependent of any of the preceding individuals. A special safe harbor rule is provided for testing whether health benefits under a cafeteria plan are discriminatory.

B. Nonstatutory Fringe Benefits

Background

The Internal Revenue Code defines gross income as including "all income from whatever source derived", and specifies that it includes "compensation for services" (sec. 61). Treasury regulations provide that gross income includes compensation for services paid other than in money (Reg. sec. 1.61-1(a)). Further, the U.S. Supreme Court has stated that Code section 61 "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected." [1]

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[1] *Commissioner* v. *Smith*, 324 U.S. 177, 181 (1945). *See also Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429-30 (1955) ("Congress applied no limitations as to the source of taxable re-

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In actual practice, however, the economic benefit test has not been rigidly followed in all situations. Thus, where compensation is paid in a form other than cash, issues as to the taxability of certain fringe benefits have been resolved by judicial decisions, regulations, rulings, or other administrative practices which take into account several different factors. For example, some economic or financial benefits furnished as compensation have been treated as excluded from income on the basis of de minimis principles; that is, accounting for some occasional benefits of small value may be viewed as unreasonably burdensome or administratively impractical. Other items have been treated as excluded in light of a combination of valuation difficulties and widely held perceptions that the particular items should not be taxed as income.

1975 Treasury discussion draft

In 1975, the Treasury Department issued a discussion draft of proposed regulations[2] which contained a number of rules for determining whether various nonstatutory fringe benefits constitute taxable compensation. The discussion draft was withdrawn by the Treasury Department on December 28, 1976.[3] Thus, the question of whether, and what, employee fringe benefits result in taxable income generally continued to depend on the facts and circumstances in each individual case.

The 1975 discussion draft proposed a "safe harbor" (i.e., nontaxable treatment) for fringe benefits meeting all of three tests: (1) the goods or services provided to the employee were owned or provided by the employer in connection with a regular trade or business; (2) the employer incurred no substantial incremental costs in furnishing the goods or services to the employee; and (3) the goods or services were made available to employees on a nondiscriminatory basis. Fringe benefits not qualifying under the safe harbor would have been evaluated in terms of a nine-part facts and circumstances test, with no single factor deemed to be controlling. In addition, the discussion draft provided a de minimis rule exempting from taxation fringe benefits of little value.

If an item was required to be taken into income under the 1975 discussion draft, the amount includible in gross income constituted the amount the employee would have had to pay for the goods or services on an arm's-length basis (i.e., fair market value).

Ways and Means Task Force discussion draft bill

On January 22, 1979, the Task Force on Employee Fringe Benefits of the House Committee on Ways and Means issued a discussion draft report and bill on fringe benefits.[4] No further action was taken by the Ways and Means Committee on the Task Force Report. The Task Force discussion draft bill would have excluded from gross income certain fringe benefits that qualified under

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ceipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted.")

[2] 40 Fed. Reg. 4118 (Sept. 5, 1975).

[3] 41 Fed. Reg. 5634 (Dec. 28, 1976).

[4] House Committee on Ways and Means, Discussion Draft Bill and Report on Employee Fringe Benefits (Comm. Print No. 96–8, 1979).

either (1) a safe harbor test, (2) a convenience of the employer test, (3) a de minimis test, or (4) regulations issued by the Treasury. Any other fringe benefits received by an employee would be includible in gross income at fair market value (less any amount paid by the employee for the benefits).

Under the safe harbor test in the Task Force bill, a fringe benefit would be excluded from gross income if: (1) it is made available to employees generally or to a reasonable classification of employees, (2) the employer incurs no substantial incremental cost in providing the fringe benefit, and (3) the total value of all fringe benefits received during the taxable year by the employee is not substantial, either in absolute terms or relative to the amount of compensation of the employee.

The convenience of the employer test would exclude from gross income fringe benefits made available primarily for the purpose of facilitating the employee's performance of services for the employer.

Under the de minimis rule in the Task Force bill, a fringe benefit would be excluded from gross income if its value is so small as to make accounting for it unreasonable or administratively impractical.

1981 Treasury discussion draft

On January 15, 1981, the Treasury Department forwarded to the House Committee on Ways and Means a revised "discussion draft" of proposed regulations on the tax treatment of fringe benefits.[5]

Under the 1981 discussion draft, the value of property, services, or facilities furnished by an employer in connection with the performance of services by an employee generally would be included in the employee's gross income. The value of any fringe benefit included in gross income would be the amount by which the fair market value of the item or its use exceeds any amount paid by the employee for the item or its use.

Certain exceptions to the general rule would have been provided. Fringe benefits consisting of items furnished by an employer with the specific intent either to enable or facilitate the performance of employment services by the recipient would be excluded from gross income. In addition, certain items would be excluded from gross income for reasons of administrative convenience, which would be determined on the basis of the facts and circumstances.

Finally, the 1981 discussion draft would exclude from gross income nondiscriminatory free or discount parking provided to employees, and occasional noncash gifts of up to $25 in value per gift.

Moratorium on issuance of regulations

Public Law 95-427, enacted in 1978, prohibited the Treasury Department from issuing, prior to 1980, final regulations relating to the income tax treatment of fringe benefits. That statute further provided that no regulations relating to the treatment of fringe benefits were to be proposed that would be effective prior to 1980.

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[5] This discussion draft was not reviewed by the Secretary of the Treasury and was not published in the Federal Register. The discussion draft was reprinted in various publications, including Bureau of National Affairs, Daily Executive Report (Jan. 16, 1981), at p. J-14.

Public Law 96-167, enacted in 1979, extended the moratorium on issuance of final fringe benefit regulations through May 31, 1981. Public Law 97-34 (the Economic Recovery Tax Act of 1981) extended the moratorium through December 31, 1983.

III. ISSUES RELATED TO TAX TREATMENT OF FRINGE BENEFITS

In general

1. Present law imposes a higher tax liability on an individual who receives no employee fringe benefits (whether or not the individual purchases the item individually) than on another individual with the same amount of economic income partially received in the form of fringe benefits which are statutorily excluded from income or are treated as tax-free because of the moratorium. Some have suggested that such disparate treatment reduces horizontal equity and contributes to the perception that the tax system is unfair.

2. By excluding certain fringe benefits from taxation, present law may encourage greater consumption of the benefit then would occur in the absence of a tax system. Some believe that the artificial subsidy of the price of certain goods and services reduces economic efficiency and distorts the ability of consumers to obtain maximum satisfaction from available resources. Further, some believe that the exclusion of certain elements of income from the tax base requires higher marginal tax rates on income which remains taxable, in order to raise the same revenue. Some suggest that these higher rates interfere with incentives to work, save, and invest. In contrast, others argue that the tax system should encourage the greater consumption of certain items because this provides a significant benefit to society which individuals do not take into account when making their consumption decisions.

3. By excluding certain fringe benefits from taxation, present law avoids administrative difficulties which could be encountered in valuing some noncash forms of compensation.

4. Some believe that rules which prohibit discrimination in favor of owners and highly compensated employees in the provision of tax-free fringe benefits are sufficient to prevent abuse. Others argue that these rules do little to limit the amount of income excluded from tax, and, thus, the revenue loss and inequity resulting from this treatment.

Moratorium on fringe benefit regulations

Some suggest that the moratorium on the issuance of fringe benefit regulations should be extended at least for another two-year period. In light of disagreements as to the proper tax treatment of certain nonstatutory fringe benefits, it is argued that there should be additional time to consider the issue of subjecting to taxation benefits which are widely available to many workers, which many taxpayers do not view as either equivalent to cash or taxable compensation, and for which there could be substantial valuation and recordkeeping problems for employers and employees alike.

Others believe that the moratorium should not be extended beyond 1983, and that the Congress either should enact guidelines for the exclusion or taxability of particular types of common nonstatutory employee fringe benefits (e.g., discounts on employer-produced goods or services, free transportation provided to employees in the transportation business, subsidized or free parking and cafeterias, etc.), or should permit the Treasury to continue its efforts to develop such rules by regulation. They suggest that extending the moratorium would encourage increased use of such benefits in lieu of cash compensation, with corresponding loss in revenue and inequality of treatment between employees of different industries, e.g., between employees of industries which can provide desirable benefits at little or no cost and employees of other industries which cannot. Also, they believe that questions as to the applicability of the moratorium to the taxation of particular fringe benefits have caused confusion and uncertainty for taxpayers and the Internal Revenue Service, as well as lack of uniform treatment among similarly situated taxpayers.

IV. EXPLANATION OF H.R. 3525

In General

Under the bill, certain fringe benefits provided by an employer would be excluded from the recipient employee's gross income for Federal income tax purposes and from the wage and benefit base for purposes of social security and other employment taxes.

The excluded fringe benefits would be those benefits that qualify under one of the following four categories as defined in the bill: (1) a no-additional-cost service, (2) a qualified employee discount, (3) a working condition fringe, or (4) a de minimis fringe. Special rules would apply with respect to parking provided to employees, demonstration use of an employer-provided car by auto salespersons, and employee use of gyms and other recreational facilities on the premises of an employer. Also, the bill would provide an exclusion for certain tuition reductions provided by and at a school or college to its employees, or their spouses or children. In the case of a no-additional-cost service, a qualified employee discount, parking, or a tuition reduction, the exclusion would apply only if the benefit is made available to employees on a nondiscriminatory basis.

Any fringe benefit which does not qualify for exclusion under the bill (for example, free or discounted goods or services which are limited to corporate officers) or under another specific statutory fringe benefit provision is taxable to the recipient, under Code sections 61 and 83, at the excess of its fair market value over any amount paid by the employee for the benefit.

The provisions of the bill generally would take effect on January 1, 1984, except that the tuition reduction exclusion would apply with respect to education furnished after June 30, 1984.

No-additional-cost Service

Under this category, the entire value of any no-additional-cost service provided by an employer to an employee for the use of the employee (or of the employee's spouse or dependent children) would be excluded for income and employment tax purposes, but only if the service is available to employees on a nondiscriminatory basis (see discussion below of nondiscrimination rules).

To qualify under this exclusion, the service must be of the same type which is sold to the public in the ordinary course of the employer's trade or business in which the employee works, and the employer must incur no substantial additional cost in providing the service to the employee. For this purpose, the term cost would include any indirect cost and any revenue foregone because the service had been made available to the employee rather than to the general public. The determination of whether the employer had incurred any substantial additional cost in providing the benefit

would be made without regard to any amounts paid by the employee for the service.

The exclusion would also be available where qualifying no-additional-cost service is provided by an employer to and for the use of an individual (or the individual's spouse or children) who formerly worked for the employer in the employer's trade or business in which the service is being provided and who separated from service with the employer in that trade or business because of retirement or disability.

As an illustration of this category of excludable benefits, assume that a corporation which operates an airline as its only trade or business adopts a policy of providing all of its employees (and their spouses and children) with free travel as stand-by passengers on the employer airline if the space taken on the flight had not been sold to the public by departure time, and that this benefit is available on terms that satisfy the bill's nondiscrimination requirements. In such a case, the entire fair market value of the free travel would be excluded under the no-additional-cost service rule in the bill. This conclusion follows because the service provided by the employer to its employees who work in the employer's airline trade or business is the same as that sold to the general public (airline flight), the service is provided at no substantial additional cost to the employer (the seat would have been unsold if the employee had not taken the trip), and the eligibility terms satisfy the nondiscrimination requirements because all employees are eligible for the benefit on the same terms.

On the other hand, this exclusion category would not apply, for example, where employees in the hotel trade or business of a corporation receive free stand-by travel on an airline operated by the same corporation, where employees of one airline receive free stand-by travel benefits on another airline through reciprocal arrangements, or where employees of a consumer goods manufacturer are allowed to travel for personal trips on a company plane or automobile even though the plane or automobile otherwise is making a trip on company business. In each of these cases, even if there were no substantial additional cost to the trade or business in providing the service, the benefit is not a service generally provided to the general public in the specific trade or business of the employer in which the employee-recipient is at the time providing services. Accordingly, the requirements of the no-additional-cost exclusion would not be satisfied.

Qualified Employee Discount

In general

Under this category, qualified discounts allowed to an employee from the selling price of the employer's goods or services (for use by the employee or the employee's spouse or dependent children) would be excluded, up to 20 percent of the selling price, for income and employment tax purposes, but only if available to employees on a nondiscriminatory basis (see discussion below of nondiscrimination rules).

To qualify under this exclusion, the goods or services on which the discount is available must be those which are offered for sale

by the employer to the general public in the ordinary course of the employer's trade or business in which the employee works. For example, goods held for sale in the retail department store trade or business of a firm would be eligible for the discount exclusion if purchased at a discount by an employee of the firm who works in that trade or business.

The exclusion would also be available where a qualified discount is provided by an employer to an individual (for use of the individual or of the individual's spouse or dependent children) if the individual had formerly worked for the employer in the employer's trade or business in which the goods or services are being provided and who separated from service with the employer in that trade or business because of retirement or disability.

Limitation on exclusion

The excludable amount of the discount would be limited to the lesser of (1) 20 percent of the price at which the goods or services are offered to nonemployee customers by the employer or (2) the employer's profit percentage, as defined in the bill.

For this purpose, the employer's profit percentage would mean the amount by which the aggregate sales price for the year of property or services sold by the employer exceeds their aggregate cost to the employer, divided by the aggregate sales price. For example, if total sales of a product during the year were $1 million and the employer's cost of the product was $850,000, then the profit percentage would be 15 percent ($1 million minus $850,000 divided by $1 million). Thus, if (for example) any employee were allowed a 19-percent discount by the employer, the excludable discount would be limited to 15 percent, and the additional discount of four percent would not be excludable.

The bill would provide that an employer may compute the profit percentage on the basis of all property or services held for sale or provided to customers in the employer's trade or business in which the employee works. As an alternative, the employer could select any reasonable classification of such property or services. For example, a retail department store business could compute a profit percentage for the store business as a whole, or may select different profit percentages for different departments or types of goods (high markup items versus low markup items), provided the classification is made on a reasonable basis. Under either computation method, the determination of the profit percentage is to be made on the basis of the employer's experience during a representative period.

Leased sections of department stores

In cases where a department store leases floor space to another employer (such as a cosmetics firm), and employees of the lessee engage in over-the-counter sales of property which appear to the public to be made by department store employees, then, for purposes of the exclusion in the bill for qualified employee discounts, the leased section would be considered as part of the department store and the employees of the leased section would be considered to be employees of the department store. Thus, even if individuals selling cosmetics on the department store floor are actually em-

ployees of the cosmetic company rather than of the store, they would be considered employees of the department store for purposes of the exclusion for qualified employee discounts. Therefore, if they receive from the store a qualified discount on their purchases of items in the store other than cosmetics, the amount of the discount (subject to the percentage limitation) would be excluded from income. Likewise, since the cosmetic section itself would be considered as part of the department store, any qualified discount allowed to department store employees by the cosmetics firm to purchase cosmetics would be excludable from income (subject to the percentage limitation).

Working Condition Fringe

In general

Under the bill, the fair market value of property or services provided primarily for the purpose of facilitating the particular employee's work for the employer would be excluded for income and employment tax purposes. This working condition exclusion would apply however, only if substantially all (for this purpose, at least 85 percent) of the use of the property or services reasonably can be expected to occur in connection with that employee's performance of services, i.e., for business purposes. For example, if an employee is provided with a company car primarily for business use and less than 15 percent of the employee's use of the car is for personal purposes, the entire value of the use of the automobile would be excludable. If the 15-percent personal use limitation is exceeded, this exclusion would not be available.

A benefit generally would be treated as a working condition fringe if it is provided by an employer primarily for the safety of its employees. For example, if for security reasons the U.S. Government provides a bodyguard or chauffered limousine to an employee stationed in a foreign country, the value of the bodyguard or of use of the limousine would be treated as a working condition fringe benefit that is not taxable to the employee. Other examples of benefits that generally would be excluded as working condition fringes include office furnishings and supplies, taxi fare provided to secretaries working late at night, and use of on-premises first-aid stations.

Parking

The fair market value of free or reduced cost parking would be excluded as a working condition fringe only if such parking is available on a nondiscriminatory basis (see discussion below of nondiscrimination rules).

Demonstration use by auto salespersons

Under the bill, the fair market value of the use of an employer-provided car by an automobile salesperson would be considered an excludable working condition fringe if (1) the car is provided primarily for the purpose of facilitating the employee's performance of services for the employer, (2) substantially all the use of the car by the salesperson occurs in the geographic sales area in which the

auto dealer's sales office is located, and (3) there are substantial restrictions on the personal use of the car by the salesperson. For example, if an auto salesperson is required to drive the make of car which the auto dealer sells, is limited in the amount of miles he or she may drive the auto, may not store personal possessions in the auto, and is prohibited from using the car for vacation trips, such restrictions generally would be considered substantial for purposes of this rule.

De Minimis Fringe

Under the bill, if the fair market value of property or services which otherwise would be a taxable fringe benefit is so small that accounting for it would be unreasonable or administratively unpracticable, then the value would be excluded for income and employment tax purposes.

In determining whether the de minimis exclusion applies, the values of all property or services provided to an employee during a calendar year would be aggregated, except for (1) property or services that are excluded from taxation under a specific statutory exclusion provision (such as qualified employee discounts) and (2) any other property or service provided to the employee which had more than a small fair market value. Examples of benefits which generally would be excludable as de minimis fringes would include the typing of personal letters by an employee's secretary, occasional company cocktail parties or picnics for employees, traditional holiday gifts of property with a low fair market value, and reduced-cost cafeterias available to all employees.

Nondiscrimination Rules

To qualify under the bill for the no-additional-cost service exclusion, the qualified employee discount exclusion, the parking exclusion, or the qualified tuition reduction exclusion (described below), the benefit must be available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer that does not discriminate in favor of officers, owners, or highly compensated employees.

The determination of whether a particular classification is reasonable would depend on the facts and circumstances involved. A classification that, on its face, provides benefits only to officers, shareholders, or highly compensated employees is per se discriminatory, and no exclusion would be available for the value of such benefits. On the other hand, an employer could establish a classification that is based on certain appropriate factors, such as seniority or job description, provided that the effect of the classification is nondiscriminatory. Thus, for example, if an employer makes free or reduced-cost parking available to all its employees on the basis of seniority, and if those employees who have parking spaces constitute a fair cross-section of all employees, then the fair market value of the parking spaces provided would be excluded under the bill. On the other hand, if an employer provides free or reduced-cost parking only to highly compensated employees, the fair market value of the parking would not be excluded.

Recreational Facilities

In general, the fair market value of any on-premises recreational facility provided and operated by an employer for its employees, where substantially all the use of the facility is by the employees (or their spouses or children), would be excluded under the bill for income and employment tax purposes. The recreational facility need not be in the same location as the business premises of the employer.

Under the bill, the employer's deductions with respect to the on-site recreational facility would be limited in computing the employer's taxable income. No limitation would apply to any deduction (such as for interest or taxes) allowable to the employer without regard to the deduction's connection to a trade or business. In the case of other facility expenses such as utilities, maintenance, depreciation, etc., the deductions could not exceed the amount of gross income from the property reduced by those deductions which are allowable regardless of their trade or business connection.

For example, if an employer provided and operated handball courts on its premises to be used free of charge by its employees, under the general rule the value of the use of these courts would be excluded from the employees' income and there would be no deduction allowed for expenses attributable to the facility and otherwise deductible only as trade or business expenses. Thus, if the employer incurred $500 in taxes, $1,000 in interest, and $4,000 in operating expenses, the only deductions allowed would be $1,500 ($500 for taxes plus $1,000 for interest). However, if the employer had charged employees or others a fee to use the courts, deductions could be taken up to the amount of the fees reduced by taxes, interest, and other deductions not affected by this provision. If, in the above example, $2,500 of fees had been collected, the employer could deduct $1,000 of the operating expenses ($2,500 minus $1,500) in addition to the $1,500 in taxes and interest.

At the employer's election, the exclusion under the bill with respect to recreational facilities would not be available to its employees; in that case, the deduction limitation would not apply to the employer. The election would be made for any taxable year in a time and manner as prescribed in Treasury regulations. Any election made generally would apply to all recreational facilities of the employer; the election would not be available on a facility-by-facility basis. Once made, an election could not be revoked without permission of the Internal Revenue Service.

Nonapplicability to Certain Fringe Benefits

No fringe benefit would be excluded under the bill (other than a de minimis fringe) if another section of the Internal Revenue Code provides rules for the tax treatment of that general type of benefit. For example, the fair market value of day care services provided to an employee would be excludable only pursuant to the provisions of Code section 129. If in a particular situation such services do not qualify for exclusion under section 129 (because, e.g., the nondiscrimination requirements of that section are not met), no exclusion (other than the de minimis exclusion) would be available under the bill.

Qualified Tuition Reductions

The bill would amend Code section 117 (relating to scholarship and fellowship grants) to exclude, for income and employment tax purposes, the amount of any reduction in tuition provided by an educational institution to its employee for the education at such institution of the employee (or of the employee's spouse or dependent children), if such benefits are made available to employees on a nondiscriminatory basis (see discussion above of nondiscrimination rules).

The exclusion would not apply with respect to tuition for education at the graduate level. No exclusion would be provided under the bill if an employee working for a school or college receives a reduction in tuition with respect to studies at a different educational institution.

The qualified tuition reduction provision of the bill would apply with respect to education furnished after June 30, 1984.

Cafeteria Plans

The bill would amend the definition of cafeteria plans for purposes of Code section 125 to provide that such plans may offer employees choices only among cash or those fringe benefits (other than scholarships or fellowships, educational assistance, vanpooling, and those benefits excludable under provisions of the bill) that are excludable from gross income under a specific section of the Internal Revenue Code.

Effective Date

The provisions of the bill generally would take effect on January 1, 1984, except that the tuition reduction exclusion would apply with respect to education furnished after June 30, 1984.

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